STATEMENT OF

CAPTAIN DUANE WOERTH, PRESIDENT

AIR LINE PILOTS ASSOCIATION, INTERNATIONAL

BEFORE THE

SUBCOMMITTEE ON AVIATION

COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE

U.S. HOUSE OF REPRESENTATIVES

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United States-European Union Air Services
And DOT's NPRM on Foreign Control of U.S. Airlines

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Good morning. I am Duane Woerth, the President of the Air Line Pilots Association. ALPA represents over 62,000 pilots at 39 airlines in the United States and Canada. We appreciate the opportunity to appear before this Subcommittee today to present our views on the initialed text of a possible air services agreement between the United States and the European Union and on the U.S. Department of Transportation's proposed policy on foreign control of U.S. airlines that is linked to that text. We have deep reservations about both the initialed text and DOT's proposal. We also fully support H.R. 4542, which is designed to ensure that Congress has an opportunity for meaningful review of DOT's proposal and its implications.

The Proposed U.S. – EU Text

With respect to the initialed text, ALPA believes that it offers little to U.S. airlines, but much to their EU counterparts. That text would allow any European airline to fly from any point in Europe to any point in the U.S. and beyond. For example, Lufthansa could fly from Paris to Atlanta; Air France could fly from Munich to Chicago. Thus, the initialed text would solve the problems raised for the Member States of the European Union by the December 2002 European Court of Justice decision that found that the ownership and control clauses in the bilateral agreements between the United States and individual European Member States were illegal because they violated the right of establishment provisions of the EU's organizational statutes. The text would also facilitate the consolidation of European airlines, potentially allowing them to be more efficient and effective competitors vis a vis U.S. carriers. In addition, under the initialed text EU carriers would receive the right to provide aircraft and crew to U.S. airlines on international routes, a right they have long sought, but which appears to be in square violation of the Federal Aviation Regulations and directly threatens the jobs of U.S. airline pilots. Clearly the initialed text provides substantial benefits to EU carriers.

What would U.S. carriers get if the initialed text were to go into effect? Apart from some additional routes beyond European gateway points that our cargo carriers might use, not much. In June 2004, the U.S. Government Accountability Office issued a report titled "Transatlantic Aviation: Effects of Easing Restrictions on U.S.-European Markets." That report contained an assessment of what U.S. carriers and consumers stood to gain if the U.S. entered into an "open skies" agreement with the EU that eliminated, as does the initialed text, the nationality restrictions on EU carriers. The

GAO concluded that whatever benefit U.S. carriers and consumers would eventually gain from such an agreement would not be realized for several years. This, according to the GAO, is because the U.S. already has open access to the vast majority of European traffic and the only significant restricted market -- London -- is subject to significant airport capacity constraints that would not be eliminated by a liberalized agreement. In other words, in the GAO's view, U.S. carriers were not likely to benefit in the short term and possibly only to a small extent even in the longer term by a US-EU "open skies" agreement similar to the initialed text.

But as favorable as the initialed text is for European carriers, they want more. Throughout the negotiations the European carriers sought the inclusion in any new agreement of the right for them to own and control U.S. airlines. Although that right was not included in the initialed text, at the end of the negotiations the Commission expressly linked the outcome of DOT's rulemaking process to the EU's decision to finally accept or reject that text.

<u>The Foreign Control Rulemaking</u>

So let me turn to that rulemaking process and DOT's proposed policy change.

The Department's proposal, which was issued on the eve of the last round of the negotiations that resulted in the initialed text, would permit foreign interests to exercise actual control over all the commercial elements of a U.S. air carrier's business, including such fundamental matters as "choice of markets, type of equipment, and rate-setting."

Under the proposal U.S. citizens would have to maintain actual control of only four areas:

1. The carrier's "organizational documentation, including such documents as charter of incorporation, certificate of incorporation, by-laws, membership agreements, stockholder agreements, and other documents of similar nature;"

2. The carrier's "[d]ecisions whether to make or continue Civil Reserve Air Fleet (CRAF) commitments, and, once made, the implementation of such commitments with the Department of Defense;"

3. The carrier's "policies and implementation with respect to transportation security requirements specified by the Transportation Security Administration;" and

4. The carrier's "policies and implementation with respect to safety requirements specified by the Federal Aviation Administration."

As long as these four areas remain under U.S. control -- and the other requirements of the statute relating to place of incorporation, ownership of voting stock, and the citizenship of managers and directors, are met -- the Department would permit foreign citizens to control all other parts of the carrier's business and operations, including rates, routes, fleet structure, marketing, alliances and branding. As United Airlines CEO Glenn Tilton put it in a recent speech to the UK Aviation Club, the proposal "would allow foreign investors in U.S. airlines to effectively control the bulk of the airline's commercial operations."

We believe there are a number of flaws in the Department's proposal.

The Statutory Issue

First, DOT's proposal is simply at odds with Congress's determination that actual control of a U.S. air carrier must be in the hands of U.S. citizens. While the four areas over which the Department would continue to require U.S. citizen control may have their importance, they are ultimately peripheral to an airline's core business operations and strategy. Control over the four narrowly defined areas simply does not add up to the "actual control" of the entire air carrier as required by Congress. The most critical issues that managers of a U.S. airline must address are such matters as the markets to be served, the type of aircraft to be flown, the alliances to participate in, the extent to which the carrier out-sources maintenance and other services, the carrier's schedules, fares, etc. These are the fundamental economic decisions that determine the very nature of an airline's operations, and its role in the air transportation system. To permit these matters to be controlled by foreign citizens, as the Department proposes to do, simply cannot be reconciled with the statutory requirement that U.S. citizens retain "actual control" of the airline.

DOT's NPRM acknowledges that, unless Congress changes them, the Department cannot alter the statutory standards that define a carrier's U.S. citizenship -- i.e., the requirements relating to place of incorporation, ownership of the voting stock, and the citizenship of managing officers and directors -- because they are mandated by law. The same is true of the "actual control" requirement. Indeed, the underlying purpose of all the statutory requirements is to ensure that U.S. citizens retain actual control of a U.S. airline. Without "actual control," the other statutory requirements are meaningless.

Application of the "actual control" standard does require analysis of the specific facts and circumstances of each particular case and thus the Department does have some discretion to define the criteria for determining whether U.S. citizens have "actual control" of a carrier. That discretion, however, does not give the Department authority to change the plain meaning of the term "actual control" itself, so that control over such basic matters as a carrier's route selection, fare structure, or choice of aircraft is simply excluded from the definition of "actual control." This is not interpretation but legislation, and it is the province of Congress, not the Department.

Apart from the legal issues there are a number of policy issues raised by the Department's proposal.

The Impact on U.S. Airlines and Jobs

A key policy issue, in our view, is whether foreign air carriers should be permitted to acquire or exercise the kind of control over the basic business decisions and strategy of U.S. air carriers that the proposed rule change would permit.

Remarkably, the NPRM does not address this issue at all. Rather, it speaks throughout of hypothetical foreign investors in U.S. carriers, without any effort to distinguish between investments by foreign air carriers and other potential sources of foreign capital. But the distinction is of crucial importance.

When one air carrier seeks to acquire control of another, the goal of the acquisition is almost always to combine the operations of the two carriers so as to create an integrated network. Since foreign carriers cannot operate domestically, the reason a foreign carrier would seek control of a U.S. carrier would normally be to combine the U.S. carrier's domestic services with the foreign carrier's international services. While this also occurs when U.S. and foreign carriers form alliances, an acquisition of control is very different from an alliance. In an alliance each carrier remains autonomous and able to protect its own economic interests. A very different situation would be created if a foreign carrier is permitted to acquire control of the key economic elements of a U.S. carrier's business strategy -- such as route structure, schedules, fleet type, and the like. In such a situation, it is inevitable that the foreign carrier would exercise its control to maximize its own interests, not those of the U.S. carrier.

What would likely happen when a foreign carrier acquires control of a U.S. carrier is that the foreign carrier would use the U.S. carrier to create a domestic network that would support and feed traffic to the foreign carrier's international operations. As a result, any pre-existing international operations of the U.S. carrier would diminish or disappear, while those of the international carrier would be expanded.

Such a result is fundamentally inconsistent with 49 U.S.C. § 40101(a)(15), which sets forth as a U.S. policy goal:

> strengthening the competitive position of [U.S.] air carriers to at least ensure equality with foreign air carriers, including the attainment of the opportunity for [U.S.] air carriers to maintain and increase their profitability in foreign air transportation. [Emphasis added.]

This goal simply could not be accomplished if foreign carriers are permitted to control the basic operations and business strategy of U.S. carriers.

The decline in international operations by U.S. carriers that would result from foreign control would also undermine the CRAF program, because it would necessarily cause a reduction in the number of long-range wide-bodied aircraft in the U.S. carrier's fleet. Although the Department's proposed rule attempts to protect the CRAF program by ensuring that U.S. citizens retain control of a carrier's CRAF commitments, the fact is that a foreign carrier that has economic control of a U.S. carrier would be able to determine how many CRAF-eligible aircraft the U.S. carrier has in its fleet. And it is predictable, for the reasons stated, that the foreign carrier's business strategy would cause that number to diminish over time.

The decline in international operations by U.S. carriers would also be injurious to U.S. airline workers, including in particular the pilots. International flying of wide-bodied aircraft is the most remunerative, and therefore the most desired, flying performed by pilots; pilots spend their entire careers accumulating the seniority required to gain access to such flying opportunities. In an era when the career expectations of pilots and other airline workers have already been repeatedly frustrated by airline bankruptcies, furloughs, wage concessions, pension plan terminations, and the like, it would be a crowning blow for the U.S. government now to adopt a policy that would tend to eliminate international flying by U.S. carriers.

U.S. workers would also suffer injury because U.S. labor laws do not apply to foreign air carriers. When two or more U.S. carriers are commonly controlled, the employees of all of them are subject to the Railway Labor Act and therefore have the same collective bargaining rights and opportunities. This allows the employees on all the affiliated carriers to try to equalize their wages and working conditions, thereby preventing the carriers from playing one employee group against another. When one of the affiliated carriers is foreign and therefore not subject to the same labor law, the employees of all the affiliates are placed at a severe disadvantage and face the prospect of being bid against each other without effective recourse against the entity (perhaps a foreign holding company) that is allocating the work. These are not hypothetical concerns. In the early 1990s when British Airways bought into US Airways, and KLM bought into Northwest, flight crew jobs were either moved to or grew disproportionately at the foreign partner.

The validity of these concerns was recognized recently by a Working Group appointed by the American Bar Association's Air and Space Forum to study the issue of whether the statutory restriction on ownership and control of U.S. airlines. The

Working Group issued a Proposed Position Statement (attached hereto) which, despite being favorably disposed to lifting the restrictions on foreign ownership and control of U.S. carriers, clearly recognized that ownership or control by foreign airlines should not be permitted until and unless special safeguards are enacted. The Working Group therefore recommended adoption of two important restrictions on foreign air-carrier control of a U.S. carrier. The first of these restrictions would require any foreign carrier that acquired control of a U.S. carrier to:

> ensure that the U.S. airline maintains at least the percentage of the combined total ASMs operated by both the U.S. airline and the foreign affiliates between the United States and any country or region that it had as of a date six months prior to the announcement of the acquisition. This condition ensures that the CRAF program has access both to a sufficient number of the appropriate (i.e., long-haul wide-body) aircraft and to the crew necessary to fly them in a military emergency. It simultaneously ensures that U.S. jobs are not transferred to foreign entities.

The second restriction proposed by the ABA Working Group would require that "[t]he U.S. government and the appropriate foreign government(s) . . . establish in advance a legal framework containing fair procedures to regulate labor representation and collective bargaining on such multinational airline systems." The purpose of this recommendation, of course, is to eliminate the unfair advantage that would otherwise result if the U.S. carrier and the foreign carrier were subject to different rules relating to labor representation and collective bargaining.

While ALPA does not endorse the Proposed Position Statement of the ABA Working Group, we do believe the statement has at least identified the basic concerns that must be addressed if any change is to be made in existing rules relating to foreign ownership or control of U.S. air carriers. The Department's NPRM has notably failed to address any of these concerns. Moreover, it seems apparent that the issues identified in the Proposed Position Statement cannot be dealt with by rulemaking. They would require basic statutory changes that only Congress can make.

The Impact on Safety

ALPA also believes that the proposed rule would not preserve U.S. citizen control of safety matters, because an airline's safety depends more on discretionary operational decisions than on compliance with minimum mandatory government regulations.

While the NPRM asserts in its preamble that "responsibility for . . . policies and procedures related to safety . . . must still be under the control of U.S. citizens to the extent that they are today," the proposed rule is written much more narrowly: it merely requires that U.S. citizens retain control of "[c]arrier policies and implementation with respect to safety requirements specified by the Federal Aviation Administration." Nothing in the proposed rule would prevent foreign investors from controlling all other safety-related decisions, so long as they do not impinge on the carrier's compliance with mandatory government regulations. There are, however, any number of economic and operational decisions that an airline's management makes that directly affect safety, even though they do not involve any issue of compliance with mandatory regulations. Safety of an airline starts at the top with those who decide business strategy and control the resources. For this very reason, the FAA has long recognized that mere compliance with minimum safety regulations does not make an airline truly safe. Rather, the FAA has been working diligently to develop and implement systems to promote and manage safety that go well beyond the minimum mandatory safety regulations.

For example, the FAA has established two major airline safety programs that are completely voluntary: the Aviation Safety Action Program (ASAP) and Flight Operational Quality Assurance (FOQA). See FAA Advisory Circular No. 120-66B, dated 11/15/02 (ASAP); FAA Advisory Circular No. 120-82, dated 4/12/04 (FOQA). The following is a brief description of each of these programs, taken from the respective FAA Advisory Circulars that establish them:

> The objective of the ASAP is to encourage air carrier and repair station employees to voluntarily report safety information that may be critical to identifying potential precursors to accidents. The Federal Aviation Administration (FAA) has determined that identifying these precursors is essential to further reducing the already low accident rate. Under an ASAP, safety issues are resolved through corrective action rather than through punishment or discipline. The ASAP provides for collection, analysis, and retention of the safety data that is obtained. ASAP safety

> data, much of which would otherwise be unobtainable, is used to develop corrective actions for identified safety concerns, and to educate the appropriate parties to prevent a reoccurrence of the same type of safety event. An ASAP is based on a safety partnership that will include the FAA and the certificate holder, and may include a third party, such as the employee's labor organization.
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> FOQA is a voluntary safety program that is designed to make commercial aviation safer by allowing commercial airlines and pilots to share de-identified aggregate information with the FAA so that the FAA can monitor national trends in aircraft operations and target its resources to address operational risk issues (e.g., flight operations, air traffic control (ATC), airports). The fundamental objective of this FAA/pilot/carrier partnership is to allow all three parties to identify and reduce or eliminate safety risks, as well as minimize deviations from the regulations. To achieve this objective and obtain valuable safety information, the airlines, pilots, and the FAA are voluntarily agreeing to participate in this program so that all three organizations can achieve a mutual goal of making air travel safer.

As the above descriptions make clear, ASAP and FOQA are voluntary programs. To participate, an airline voluntarily enters into a formal agreement with FAA and the relevant employee groups. Such agreements involve significant commitments of the airline's resources, both financial and human. For example, they require the establishment of special committees to perform specified functions set out in the agreements, they require the collection and reporting in prescribed ways of numerous types of data, they require that specific employee policies must be implemented, etc.

Under DOT's NPRM, the decision to enter into an ASAP or FOQA agreement would not have to be under U.S. citizen control, since the proposed rule provides only that U.S. citizens must control the carrier's "policies and implementation with respect to requirements specified by the Federal Aviation Administration." As previously noted, ASAP and FOQA are voluntary programs, not FAA requirements. They are, however, an important part of the FAA's continuing effort to maintain and improve the safety of U.S. airlines.

Aside from these specific programs, it is now commonly accepted by safety regulators and experts, both in the U.S. and internationally, that responsibility for safety must be shared across the entire airline, and not just relegated to a specific safety department or official. This principle has come to be known as Safety Management System (SMS). The ICAO Air Navigation Commission is currently drafting a formal SMS policy to be incorporated into Annex 6 of the Convention on International Civil Aviation, which will define the safety accountability of every element of an airline, including in particular its senior management. A similar policy is being developed in the U.S. under the aegis of the FAA's Next Generation Air Transportation System (NGATS). The NPRM's approach to the issue of safety, which presumes that responsibility for safety can be isolated from the general management of an airline, is in square conflict with the core principles of SMS programs that are being adopted by airline managements and regulators worldwide.

The fact is that all kinds of economic and operational decisions have an impact on safety. A few examples are: the decision whether or not to out-source aircraft maintenance; the selection of a specific maintenance provider; the policies concerning pilot flight and duty time; the airline's policy concerning what types and the number of replacement parts to have available in excess of the minimum FAA requirement. Thus, the very premise of DOT's proposal -- that safety management can somehow be separated from the general operational management of an airline -- is untenable, and is not accepted by safety experts or regulators.

Finally, even if it were possible and prudent -- which it is not -- to place all safety responsibilities in the hands of one individual or management group within an airline, it would be totally unrealistic to expect that such an individual or group could operate autonomously, and not be under the ultimate influence of the airline's senior management. Senior management would necessarily be responsible for hiring and firing the safety personnel, and for setting their compensation and other terms and conditions of their employment. In any such employment relationship, the subordinate employees necessarily try to please their senior management, and are alert to even the most subtle signals as to the actions and decisions that senior management would approve or disapprove. It is thus inevitable that whoever controls the operation of the airline as a whole will also ultimately control its safety policies and their implementation.

We understand that the FAA career staff was not consulted, and has therefore had no input, in connection with the preparation of the NPRM. That may account for the fact that DOT's proposal reflects so little understanding of how an airline's safety practices and policies are actually determined and managed. We believe that these matters must be given full exploration before any change in the actual control rule is considered.

The Impact on Existing Air Service Agreements

The Department's proposed policy change is also at odds with the control provisions in the United States' Air Service Agreements. The vast majority, if not all, of the air service agreements between the United States and foreign countries have provisions that require "effective control" of airlines designated by the U.S. to be vested in the U.S. or its nationals. In these agreements the control requirement applies to the airline as an entity, not to discrete elements or components of the airline. Should the Department permit foreign persons to control the operational and economic aspects of a U.S. carrier, a bilateral partner could assert that the carrier is no longer entitled to conduct international air transportation under the pertinent air services agreement. Thus, every U.S. carrier that availed itself of the proposed control policy would subject its eligibility to conduct international operations to challenge.

The Lack of Supporting Data

Finally, the Department has presented no data either to support its claim that the U.S. airline industry is in need of more foreign investment, or its claim that such investment is not available absent a change in the foreign control rules. We believe that the fundamental premise on which the NPRM appears to be based -- that the U.S. airline industry is in need of "enhanced access to worldwide financial resources," and that such access to foreign capital cannot be achieved without granting foreign investors substantial control of U.S. carriers -- is erroneous. Certainly, the NPRM contains no hard data to substantiate these propositions, and we are not aware that any such data are available.

In fact, there is evidence that when a U.S. airline shows some significant promise of profitability, it is able to find the capital it needs. For example, United Airlines, after engaging in extensive restructuring, cost-cutting and changes in operations and services while in Chapter 11, was able to obtain $3 billion in debt exit financing on terms that pleased United's management. The airline's own press release stated that it had received offers of subscription for more than twice the capital necessary to support the financing it sought and that the money was provided at rates better than it had expected to receive. Similarly, US Airways, after going through its own Chapter 11 restructuring and merging with America West, obtained $1.5 billion in exit financing, of which $350 million was in the form of equity commitments. Moreover, $75 million of the equity was foreign investment provided by ACE Aviation Holdings, the parent of Air Canada. These major financings strongly indicate that both foreign and domestic capital is available to U.S. airlines if they appear to offer a reasonable return to the investor.

If there is hard evidence that the U.S. airline industry is seriously suffering from a dearth of capital, and that the existing rules relating to foreign control are somehow responsible for the problem, that evidence has yet to be produced. Before lack of capital is used as a rationale for considering dramatic changes in the foreign control rules, there should be a thorough and systematic study to determine whether the problem it is attempting to cure actually exists.

Conclusion

In sum, DOT's proposed rule essentially rewrites the statutory rule on "actual control" recently enacted by Congress. The Department's proposal would have broad, potentially negative effects on the competitive posture of US airlines and their employees and raises a number of key public policy issues that have not been adequately addressed by the Department. Consideration of changes of this magnitude should be undertaken not by an administering agency but by Congress. H.R. 4542 is thoughtfully designed both to afford time for Congress to consider whether a change to the control rules is appropriate and to help develop a record on which that consideration can be based. We urge this subcommittee to support this measure and to ensure that the DOT does not unilaterally impose changes to the longstanding rules on "actual control" of U.S. airlines.